

THE CHARTERED INSTITUTE OF TAXATION

APPLICATION AND PROFESSIONAL SKILLS

Taxation of Individuals

May 2024

TIME ALLOWED

3 HOURS 30 MINUTES

- In order to secure a pass in this exam, you will be required to demonstrate competence in each of three skills.

You will be assessed across your answer as a whole for Structure. A pass or fail grade will be awarded.

You will be assessed for competence in a number of broad topics for the following skills:

- Identification and Application
- Relevant Advice and Substantiated Conclusions

For each topic for each of these two skills, a grade will be awarded. The grades for those topics will be weighted and averaged to produce a final grade for each skill of 0, 1, 2, 3 or 4. A grade of 3 or 4 is required to demonstrate competence.

- All workings should be shown and made to the nearest month and pound unless the question specifies otherwise.
- Candidates who answer any law elements in this paper in accordance with Scots law or Northern Ireland law should indicate this where relevant.
- Scots law candidates may provide answers referring to Land and Buildings Transaction Tax rather than Stamp Duty Land Tax.
- Unless otherwise indicated by the provision of additional information in the question, you may assume that 2023/24 legislation (including rates and allowances) continues to apply for 2024/25 and future years. Candidates answering by reference to more recently enacted legislation or tax cases will not be penalised.
- You must type your answer in the space on the screen as indicated by the Exam4 guidance.

You are a tax senior in a firm of Chartered Tax Advisers. Your client is Sarah Masters.

Sarah has written to your manager (**EXHIBIT A**), Anthony Day, seeking tax advice in relation to changes in her employment due to illness, and also in relation to the investment of her funds to help cover expenses until she starts to receive her occupational pension.

The following exhibits are provided to assist you:

EXHIBIT A: Email from Sarah Masters

EXHIBIT B: Extracts from Rules covering all EMI Share Option Agreements between Tea & Biscuits Ltd (the Company) and Sarah Masters (the Employee)

EXHIBIT C: Pre-seen information

Requirement:

Prepare a draft report to Sarah Masters containing recommendations on actions to take and advice on tax implications in relation to her email of 1 May 2024.

Continued

EXHIBIT A

Email from Sarah Masters

To: Anthony Day
From: Sarah Masters
Date: 1 May 2024
Subject: Tax Advice

Dear Anthony

Employment

Unfortunately, I have not been well recently and I have received medical advice that I can no longer work full-time.

My employer, Tea & Biscuits Ltd, has offered me the option of either ending my employment, or a reduced part-time role. The terms I have been offered are as follows:

Termination

- 1) Three months' salary to cover my notice period (my annual salary is £150,000).
- 2) An additional non-contractual payment of £60,000.
- 3) In relation to my share options, I can either:
 - (a) exercise all options within 14 days of termination. I would be required on exercise to sell my shares back to Tea & Biscuits Ltd for £0.27 per share, which is the current market value, or;
 - (b) keep the share options and exercise them when Tea & Biscuits Ltd obtains a stock exchange listing.
- 4) The termination date would be 1 June 2024.

Part-time role

- 1) 10 hours work per week, commencing 1 June 2024.
- 2) I will be paid my full-time salary of £150,000 until 31 August to cover my notice period and after this my annual salary will drop to £37,500.
- 3) I can keep my share options and exercise them when Tea & Biscuits Ltd obtains a stock exchange listing.

Tea & Biscuits Ltd is due to list on the stock market in December 2024. Based on the market capitalisation of other similar businesses, I believe the share price on listing could be significantly higher than the price I would get now if I take the termination option.

I am keen to stop working and leave Tea & Biscuits Ltd. If I take the part-time position, I will resign once I have exercised my share options in December 2024. I don't intend to look for another job.

Please could I have your advice and recommendations in relation to the tax consequences of either accepting the termination or continuing to work part-time at Tea & Biscuits Ltd?

Continued

Continuation

I am considering two possible uses for the money I will receive from Tea & Biscuits Ltd. These are as follows:

Option 1 – Lend £150,000 to SM Rental Ltd

There is an outstanding mortgage of £150,000 on the property owned by SM Rental Ltd. The fixed rate period on the mortgage will expire at the end of this year, when the interest rate will increase from 3.3% to 10%, which will effectively reduce the company's profit to zero.

I could lend £150,000 to SM Rental Ltd, which will use it to pay off the mortgage. With no mortgage, SM Rental Ltd would make a profit of approximately £15,000 annually, which I would like to withdraw from the company each year in as tax efficient a way as possible.

Option 2 – Make a gross pension contribution of £150,000

My financial adviser suggested that, separately from my occupational pension with Tea & Biscuits Ltd, I could also open a SIPP with a lump sum pension contribution. The financial adviser has confirmed that I have sufficient Annual Allowance available, including unused amounts from previous years, to contribute £150,000 gross into a SIPP (even if I stop work). The money would be invested within the SIPP and I could then withdraw funds over the next five years and beyond, as required, to help fund my living expenses.

After Tea & Biscuits Ltd

I will start receiving my occupational pension in just over five years, in 2030. This will pay approximately £30,000 per year. I intend to draw down my savings over the next five years to take me through until I start receiving the pension.

I hope to supplement my savings and pension by withdrawing either £15,000 annual profit from SM Rental Ltd, or drawing a similar amount of income from funds invested in my SIPP (or a combination of the two), on an ongoing basis.

I would like your advice on the tax consequences of lending money to SM Rental Ltd and/or using it to make a pension contribution, in order to ensure I maximise the amount I receive from Tea & Biscuits Ltd and am also able to draw on my funds tax efficiently going forward.

Kind regards

Sarah Masters

Continued

EXHIBIT B

Extracts from Rules covering all EMI Share Option Agreements between Tea & Biscuits Ltd (the Company) and Sarah Masters (the Employee)

Tax And National Insurance Contributions (NIC)

The Employee irrevocably agrees:

(a) to reimburse the Company for any secondary class 1 (employer) NIC that the Company is liable to pay in relation to the grant of options, exercise of options, holding of shares and sale of shares.

(b) on exercise of the Options the Company will be entitled to sell an amount of shares sufficient to cover the amount of any liability to Tax and NIC.

Termination of Employment

If the Employee ceases to be an Employee because of any of the following reasons:

- (a) injury;
- (b) ill health; or
- (c) disability; or
- (d) retirement; or
- (e) redundancy;

the Employee may exercise such proportion of the Option as the Company may specify. The Option shall lapse, to the extent it has not been exercised, 14 days after the date the Employee ceases employment with the Company, unless the Company specifies otherwise.

Continued

EXHIBIT CPre-seen information

Client name	Sarah Masters
Date and place of birth	05 May 1963, United Kingdom
Children	None
Residence	United Kingdom
Will	All assets to be left to Shropshire Cat Sanctuary
Employment	Employee of Tea & Biscuits Ltd

Asset Schedule 1 May 2024Shares in SM Rental Ltd

Sarah owns 100% of SM Rental Ltd, an unquoted property company, of which she is sole director.

SM Rental Ltd owns one residential property, which is let long-term to a third party. Profits are extracted by way of dividends.

Unexercised EMI share options in Tea & Biscuits Ltd

Sarah has been granted share options over a total of 667,098 shares in her employer Tea & Biscuits Ltd. The options meet all qualifying conditions of the Enterprise Management Incentive Scheme. Sarah has not previously claimed business asset disposal relief.

<u>Date granted</u>	<u>No. of shares</u>	<u>Unrestricted Market Value at grant per share (£)</u>	<u>Total Unrestricted Market Value at grant (£)</u>	<u>Option exercise price per share (£)</u>
31 March 2018	200,000	0.05	10,000	0.05
31 March 2019	142,857	0.07	10,000	0.07
31 March 2020	166,666	0.06	10,000	0.06
31 March 2021	90,909	0.11	10,000	0.11
31 March 2022	<u>66,666</u>	0.15	<u>10,000</u>	0.15
Total	667,098			

Pension

Sarah's employer provides a defined benefit occupational pension scheme.

Savings

Sarah has £100,000 in a cash ISA.

Main Residence

Sarah's home is mortgage-free and its value is £500,000.

Continued

Sarah Masters – 2023/24 Tax Return

Tax Calculation

	£
Pay from all employments	150,000
Dividends from UK companies	<u>10,000</u>
Total income on which tax is due	<u>160,000</u>
Pay, pensions, profits:	
Basic rate £37,700 x 20%	7,540
Higher rate £87,440 x 40%	34,976
Additional rate £24,860 at 45%	11,187
Dividends from companies:	
Nil rate £1,000 x 0	0
Additional rate £9,000 x 39.35%	<u>3,541</u>
Income Tax due	<u>57,244</u>